



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-75983; File No. SR-ICEEU-2015-013]

### Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to CDS End-of-Day Price Discovery Policy

September 25, 2015

#### I. Introduction

On July 24, 2015, ICE Clear Europe Limited (“ICE Clear Europe”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its end-of-day price discovery policies and procedures for credit default swap (“CDS”) contracts to incorporate certain enhancements (SR-ICEEU-2015-013). The proposed rule change was published for comment in the Federal Register on August 12, 2015.<sup>3</sup> The Commission did not receive comments on the proposed rule change. The Commission is approving the proposed rule change.

#### II. Description of the Proposed Rule Change

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 34-75624 (Aug. 6, 2015), 80 FR 48369 (Aug. 12, 2015) (SR-ICEEU-2015-013).

ICE Clear Europe has proposed to amend its CDS End-of-Day Price Discovery Policy (the “EOD Price Discovery Policy”) to make certain enhancements to the end-of-day submission and firm trade process for CDS contracts. ICE Clear Europe also proposed to adopt a new Price Submission Disciplinary Framework (the “Disciplinary Framework”) that addresses missed price submissions by Clearing Members for CDS contracts. ICE Clear Europe did not otherwise propose to change its Clearing Rules or Procedures in connection with these amendments.

As described by ICE Clear Europe, under the EOD Price Discovery Policy, ICE Clear Europe currently utilizes a “cross and lock” algorithm as part of its CDS price discovery process. Under this algorithm, standardized bids and offers derived from Clearing Member submissions are matched by sorting them from highest to lowest and lowest to highest levels, respectively. This sorting process pairs the Clearing Member submitting the highest bid price with the Clearing Member submitting the lowest offer price, the Clearing Member submitting the second highest bid price with the Clearing Member submitting the second-lowest offer price, and so on. The algorithm then identifies crossed and/or locked markets. Crossed markets are the Clearing Member pairs generated by the sorting and ranking process for which the bid price of one Clearing Member is above the offer price of the matched Clearing Member. The algorithm identifies locked markets, where the bid and the offer are equal, in a similar fashion.

According to ICE Clear Europe, whenever there are crossed and/or locked matched markets, the algorithm applies a set of rules designed to identify standardized submissions that are “obvious errors.” The algorithm sets a high bid threshold equal to the preliminary end-of-day (“EOD”) level plus one bid-offer width (“BOW”), and a low offer threshold equal to the preliminary EOD level minus one BOW. The algorithm considers a Clearing Member’s

standardized submission to be an “obvious error” if the bid is higher than the high bid threshold, or the offer is lower than the low offer threshold.

Clearing Member pairs identified by the algorithm as crossed or locked markets may be required from time to time, under the EOD Price Discovery Policy, to enter into cleared CDS trades with each other (“Firm Trades”). Currently, ICE Clear Europe excludes standardized submissions it identifies as obvious errors from potential Firm Trades and does not use these submissions in its determination of published EOD levels.

ICE Clear Europe has proposed to impose certain consequences under the Firm Trade methodology for Clearing Members providing price discovery submissions deemed to be obvious errors. ICE Clear Europe has represented that, as revised, the process for determining potential Firm Trades will now include all standardized submissions, including those classified as obvious errors (and as a result submissions that are obvious errors may result in Firm Trades). However, obvious errors will not be used in the calculation of the final EOD level, as under the current framework. Thus, ICE Clear Europe has represented that it will effectively execute its current EOD algorithm twice: initially in the same way it does today (eliminating obvious errors) to generate the final EOD levels, and again, without excluding obvious errors, to generate Firm Trades and related reversing transactions.<sup>4</sup>

To limit the potential exposure created through Firm Trades that include a bid or offer from an obvious error submission, ICE Clear Europe has represented that it will adjust Firm Trade prices, where appropriate, to fall within a predefined band on either side of the EOD price

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<sup>4</sup> A reversing transaction is a second cleared transaction with identical attributes to the initial Firm Trade, but with the buyer and seller counterparties reversed, and at that day’s EOD price rather than the initial Firm Trade price.

such that the potential profit or loss (“P/L”) realized by unwinding the trade at the EOD level is capped.

To prevent Clearing Members from receiving Firm Trades with large P/L impact in certain index instruments that are less actively traded, and for which it is therefore more difficult and/or more expensive to manage the associated risk, ICE Clear Europe has represented that it will automatically generate reversing transactions at the end-of-day price level for specific index CDS instruments (i.e., for specific combinations of index/sub-index and series determined by the ICE Clear Europe risk department in consultation with the trading advisory committee). Currently, reversing transactions are only available for eligible single name CDS instruments.

ICE Clear Europe has also proposed revising the EOD Price Discovery Policy to remove the option for Clearing Members to provide end-of-day price submissions for single name CDS instruments in terms of spread and associated recovery rate. Under the revised approach, Clearing Members will be required to provide price submissions (or equivalent “points upfront” submissions) for all single name CDS instruments. Clearing Members may provide a recovery rate, which ICE Clear Europe will use for purposes of its own analysis. Accordingly, ICE Clear Europe will no longer need to convert spread submissions for single name instruments into a price level for purposes of the EOD price determination process. Various conforming changes will be made throughout the policy as a result.

ICE Clear Europe has also proposed to implement a new Disciplinary Framework, which addresses failures by a Clearing Member to provide required EOD price submissions for CDS Contracts in which they hold cleared open interest with ICE Clear Europe (“Missed Submissions”). For purposes of the Disciplinary Framework, obvious errors (as described above) with respect to CDX index CDS contracts will also be treated as Missed Submissions

(since such instruments are not subject to Firm Trade requirements). ICE Clear Europe has represented that it will impose a cash assessment on Clearing Members for each Missed Submission, generally ranging from \$1,000 to \$4,000, depending on whether the Missed Submission related to an index or single-name, whether it occurred on an announced firm trade date and whether the related contract is actively traded. For single name CDS contracts, the framework will also specify an aggregate daily maximum assessment per Clearing Member for multiple Missed Submissions and a daily maximum assessment per Clearing Member per risk sub-factor.

As part of a new summary assessment process, ICE Clear Europe has represented that it will determine on a monthly basis whether a Clearing Member has any Missed Submissions and provide the Clearing Member a notice of assessment with details of such Missed Submissions. The notice of assessment will include information about the date, type, quantity and assessment amount for the relevant Missed Submission(s). The Disciplinary Framework will also provide a procedure for a Clearing Member to dispute a notice of assessment. ICE Clear Europe has represented that a Clearing Member will have fifteen days from the notice of assessment to dispute the notice or seek to have it waived or rescinded. ICE Clear Europe has represented that it may grant a waiver of an assessment for certain specified reasons. A conditional waiver may be granted for the first instance of a Missed Submission for a particular instrument, provided that the Clearing Member does not have another Missed Submission in that instrument within 90 days. ICE Clear Europe has represented that it may grant an unconditional waiver where Missed Submissions result from extraordinary circumstances outside of the Clearing Member's control, such as market-wide disruptions. ICE Clear Europe has represented the imposition of a cash assessment on a Clearing Member does not preclude

ICE Clear Europe from taking any other disciplinary action against a Clearing Member under the Rules and Procedures, including for persistent failures to meet the requirements of the EOD Price Discovery Policy.

### III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>5</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if the Commission finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such self-regulatory organization. Section 17A(b)(3)(F) of the Act<sup>6</sup> requires, among other things, that the rules of a clearing agency are designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions and, in general, to protect investors and the public interest.

The Commission finds that ICE Clear Europe's proposed revisions to its EOD Price Discovery Policy and its proposed new Disciplinary Framework are consistent with the requirements of Section 17A of the Act<sup>7</sup> and rules thereunder applicable to ICE Clear Europe. The proposed revisions are intended to enhance ICE Clear Europe's price discovery process by including all price submissions (including those classified as obvious errors) in the process of determining Firm Trades, thereby strengthening the incentives for Clearing Members to provide

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<sup>5</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>7</sup> 15 U.S.C. 78q-1.

accurate end-of-day price submissions. In addition, the proposed rule change would adjust the trading prices of Firm Trades that include a bid or offer classified as an obvious error to fall within a predefined range on either side of the EOD price, thereby limiting Clearing Members' potential P/L exposure to obvious errors from the risk management perspective, while holding them accountable for their price submissions. The proposed rule change would also assist Clearing Members in unwinding Firm Trades in certain less actively traded index products by automatically generating reversing trades at the EOD level. Finally, the proposed rule change further incentivizes accurate price submissions by imposing financial consequences on Clearing Members for Missed Submissions, through cash assessments under the new Disciplinary Framework. The Disciplinary Framework is intended to further enhance compliance with the EOD Price Discovery Policy and provides Clearing Members with notice and a mechanism to dispute any Missed Submissions or seek a waiver of any assessments.

The Commission therefore believes that the proposal is designed to promote the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts and transactions cleared by ICE Clear Europe and, in general, to protect investors and the public interest, consistent with Section 17A(b)(3)(F) of the Act.<sup>8</sup> The Commission further believes that the proposed Disciplinary Framework is designed to subject participants to appropriate discipline for violation of ICE Clear Europe's end-of-day price submission requirements, consistent with section 17A(b)(3)(G) of the Act.<sup>9</sup> Finally, the Commission

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<sup>8</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>9</sup> 15 U.S.C. 78q-1(b)(3)(G).

believes that the proposed Disciplinary Framework provides a fair procedure with respect to the disciplining of participants, consistent with section 17A(b)(3)(H) of the Act.<sup>10</sup>

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>11</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>12</sup> that the proposed rule change (SR-ICEEU-2015-013), is approved.<sup>13</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

**Robert W. Errett,**  
*Deputy Secretary.*

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<sup>10</sup> 15 U.S.C. 78q-1(b)(3)(H).

<sup>11</sup> 15 U.S.C. 78q-1.

<sup>12</sup> 15 U.S.C. 78s(b)(2).

<sup>13</sup> In approving the proposed rule change, the Commission considered the proposed rule change's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 17 CFR 200.30-3(a)(12).